



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Number: **201108037**
Release Date: 2/25/2011

Date: November 29, 2010

UIL: 512.00-00; 514.07-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

LEGEND:

Address =
Year 1 =
Year 2 =
Date 1 =
Date 2 =
X =

Dear :

We have considered your ruling request dated March 14, 2008 (as supplemented by your letters of May 10, 2010 and June 17, 2010), concerning the federal income tax consequences under sections 511, 512, and 514 of the Internal Revenue Code ("Code"), relating to the proposed sale of your principal place of operations located at Address (hereinafter referred to as "Building").

FACTS

You are exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). For foundation classification purposes, you were originally classified as a publicly-supported charity under section 509(a)(2). In Year 2, you asked the Internal Revenue Service (the "Service") to reconsider your private foundation status. Consequently, on Date 1, the Service modified your foundation status to reflect an organization described in sections 509(a)(1) and 170(b)(1)(A)(ii).

You own the Building, which is an eight-story office building. You conduct activities in part of the Building and lease the remainder of the Building to unrelated parties for purposes unrelated to your exempt purposes. The Building is currently encumbered by a deed of trust securing a promissory note evidencing a loan in the principal amount of approximately \$x. The note is a refinancing of earlier loans secured by the Building. You obtained the original loan in Year 1 to acquire the land on which the Building was built. That loan has been refinanced

several times, with the amount borrowed increased at times to cover additional capital expenditures and improvements to the Building and operational expenditures.

Your board of directors has determined that it is in your best interest to sell the Building and move to a new location that would better serve your membership.

RULING REQUESTED

You have requested the following ruling:

The sale of Building will not result in the imposition of the unrelated business income tax by reason of sections 512(b)(5) and 514(c)(9)(C) of the Code.

LAW

Section 511 of the Code imposes a tax on the unrelated business income of an organization described in section 501(c)(3) of the Code.

Section 512(a) of the Code defines "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business (as defined in section 513 of the Code) regularly carried on by the organization, less certain deductions allowed which are directly connected with the carrying on of such trade or business, computed with the modifications provided in 512(b) of the Code.

Section 512(b)(5) of the Code excludes from the definition of "unrelated business taxable income" all gains or losses from the sale, exchange, or other disposition of property other than (A) stock in trade or other property of a kind which would properly be includible in inventory if on hand at the close of the taxable year, or (B) property held primarily for sale to customers in the ordinary course of the trade or business.

Section 512(b)(4) of the Code provides that notwithstanding section 512(b)(5), in the case of debt-financed property (as defined in section 514), there shall be included as an item of gross income derived from an unrelated trade or business, the amount ascertained under section 514(a)(1), and there shall be allowed, as a deduction, the amount ascertained under section 514(a)(2).

Section 514(b)(1) of the Code defines the term "debt-financed property" as any property which is held to produce income and with respect to which there is acquisition indebtedness (as defined in section (c)) at any time during the taxable year (or, if the property was disposed of during the taxable year, with respect to which there was acquisition indebtedness at any time during the 12-month period ending with the date of such disposition.)

Section 514(c)(1) of the Code provides that the term "acquisition indebtedness" means, with respect to any debt-financed property, the unpaid amount of (A) the indebtedness incurred by the organization in acquiring or improving such property; (B) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; or (C) the indebtedness incurred after the

acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

Section 514(c)(3) of the Code provides that an extension, renewal, or refinancing of an obligation evidencing a preexisting indebtedness shall not be treated as the creation of new indebtedness.

With certain exceptions not applicable in this case, section 514(c)(9)(A) of the Code provides that except as provided in section 514(c)(9)(B), the term "acquisition indebtedness" does not include indebtedness incurred by a qualified organization in acquiring or improving any real property.

Section 514(c)(9)(C)(i) of the Code defines the term "qualified organization" to include an organization described in section 170(b)(1)(A)(ii).

Section 1.514(c)-1(c)(1) of the regulations provides that an extension, renewal, or refinancing of an obligation evidencing a preexisting indebtedness is considered as a continuation of the old indebtedness to the extent the outstanding principal amount thereof is not increased. Where the principal amount of the modified obligation exceeds the outstanding principal amount of the preexisting indebtedness, the excess shall be treated as a separate indebtedness for purposes of section 514 and the regulations thereunder.

ANALYSIS

You plan to sell the Building, your principal place of operations. The promissory note secured by the deed of trust that currently encumbers the Building manifests the refinancing of an obligation evidencing a preexisting indebtedness. Under section 514(c)(3) of the Code and section 1.514(c)-1(c)(1) of the regulations, the note is considered a continuation of the old indebtedness to the extent the outstanding principal amount thereof is not increased, and is considered a separate indebtedness to the extent the principal amount of the modified obligation exceeds the outstanding principal amount of the preexisting indebtedness. Nevertheless, under section 514(c)(9) of the Code, such indebtedness is not "acquisition indebtedness" within the meaning of section 514(c)(1) because it was incurred by you – an organization described in section 170(b)(1)(A)(ii) and, hence, a "qualified organization" within the meaning of section 514(c)(9)(C) – to acquire or improve real property. Consequently, the Building is not considered debt-financed property within the meaning of section 514(b)(1), and any gain or loss from the sale of the Building would be excluded from unrelated business taxable income by operation of section 512(b)(5).

RULING

Based on the information submitted, we rule as follows:

The sale of Building would not result in the imposition of unrelated business income tax under section 511 of the Code because the Building is not debt-financed property within

the meaning of section 514, and, thus, any gain on the sale of the Building would be excluded from unrelated business taxable income by reason of section 512(b)(5).

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing upon your tax status should be reported to the Service. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

Because this letter could help resolve any future questions about tax consequences of your activities, you should keep a copy of this ruling in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney and Declaration of Representative currently on file with the Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Steven Grodnitzky
Manager, Exempt Organizations
Technical Group 1

Enclosure:
Notice 437